



Procurement Process Improvement and Restructuring

Executive Summary

August 2009

Introduction

The City of Houston hired Booz & Company (formerly Katzenbach Partners) to “develop and deploy dramatically improved purchasing operations and organization, reduce costs, improve processes, and allow City Departments to focus on their core businesses” as stated in the original RFP. Given the City’s current budget constraints, particular attention was paid to cost savings opportunities and recommendations with a quick return on investment.

We estimate annual savings of \$24.6M in FY11 increasing to \$40.3M in FY12 are available through targeted improvements in central purchasing skills, processes, and practices. In addition we estimate another \$3.1M through increased productivity. In order to realize these savings the procurement process in the City of Houston should be streamlined through consolidation of overlapping functions, elimination of unnecessary steps in citywide purchasing practices, and investing in the quality of services provided by the Strategic Purchasing Division (SPD), while maintaining SPD’s current levels of efficiency. Furthermore, greater focus in SPD needs to be placed on value-added services such as specification writing and market analytics. While minimal investments are required in the short-term to achieve the overall savings, addressing these issues will net a positive return this fiscal year and reach the full annual return of \$40.3M by FY12.

The Booz & Company team began by interviewing 73 employees representing 20 departments to better understand the City procurement processes, identify issues, and find opportunities. Ten department directors were interviewed and all directors were asked if they would like to meet with the consultants as part of the interviewing process. Based on patterns identified in the interviews, the team identified potential gaps to sourcing best practices and likely areas of opportunity. These identified gaps were then compared against citywide purchasing data for verification, including the relative efficiency of the department purchasing units (DPUs) that reside within the departments and interface with the Strategic Purchasing Division (SPD). Cost savings opportunities were quantified in detail and additional opportunities to reduce overhead and administrative burden were also outlined. Finally, recommendations were developed and reviewed by SPD and ARA leadership.

Observations

During our analysis three opportunities became apparent: citywide purchasing processes are overly cumbersome, the City is not fully leveraging its purchasing power, and SPD is structured for process management and compliance rather than to drive savings.

City spend can be categorized into three buckets based on size and procedural complexity: under \$25,000, from \$25,000-50,000, and over \$50,000. Under \$25,000 purchases are



generally managed independently by the DPUs within individual City departments. Purchases between \$25,000 and \$50,000 are jointly managed by the departments and SPD. Purchases above \$50,000 – excluding capital spend over \$500,000 – require extensive SPD participation, as the City Purchasing Agent signs the RCA and must have confidence that the appropriate compliance standards were met. While 98% of transactions in the city are under \$50,000 totaling just 12% of non-capital spend, 43% of procurement employees across the City are focused on clerical execution of these high volume, low value purchases. The vast majority of expenditures – and savings opportunities – reside in contracts over \$50,000.

Citywide purchasing processes are currently cumbersome. Overstaffing and rework in the purchasing process is exemplified in buys between \$25,000 and \$50,000 that pass through both the DPU and SPD. State law, local ordinances, and internal practices all contribute to the complexity of purchasing, yet little has been done to sift through what process steps are required and what can be streamlined. The current \$25,000-\$50,000 purchasing process is not, for instance, required by state law or city ordinance. Additionally, purchases above \$50,000 are inherently more complex and take more time; nevertheless, the timely attention of the right people is often lacking. Frequently, software contracts, which are notoriously more complex than most service contracts, wait to involve the legal department until after the IT department and SPD have negotiated the contract. Legal is then contacted late in the process for a final review. As software vendors favor terms that severely limit their liability, negotiations often start anew as City lawyers object to the terms. In addition the efficiency of departmental purchasing organizations varies widely. For example, internal benchmarking reveals HAS and PWE staffing levels could be reduced by a total of 24 FTE's.

The City of Houston does not make the most of its purchasing power. With \$1.2B annually in non-capital spend, the City has the leverage to negotiate from a position of strength with many of its suppliers. While this leverage has been applied to a number of contracts, substantial opportunities remain. For instance, employees in many departments across the City buy items from Home Depot. In the field, P-card purchases at Home Depot are often more convenient than purchasing items from multiple City-approved vendors scattered throughout the area. Nevertheless, the City does not have a contract in place with Home Depot and is not rewarded for the large volume of business it provides Home Depot. In another example, contract compliance is poorly monitored throughout the City. Not only does this impact immediate service levels and costs, it also misses an impactful negotiating point when the contract comes up for renewal.

SPD is structured for process management and compliance. SPD performs a very real and necessary compliance role and is known for their deep understanding of the procurement process. Nevertheless, the central purchasing function is in a position to drive citywide savings. SPD sees a wider view of city spend; yet today, purchasing data is inconsistently analyzed to pinpoint savings opportunities. Purchasing expertise is also not evenly distributed within City departments, leaving gaps for SPD to fill on a department by department basis. For example there are no professional specification writers within SPD.

There is an important opportunity for SPD to expand its existing role into a more strategic organization focused on savings opportunities.

Recommendations

The observations point to a need to streamline the process, improve SPD service, and organize central purchasing to deliver savings to the City.

1. Streamline the procurement process. Too many people and steps are involved in under \$50,000 purchasing, while purchases over \$50,000 do not involve the right people at the right time. We recommend the following actions to reduce excessive administration and rework:

- Simplify the purchasing process by eliminating redundant roles and unnecessary steps
- Consolidate the DPUs into SPD for departments with simple purchasing needs and raise the DPU spending limit from \$25,000 to \$50,000 for efficient or sophisticated departments
- Redeploy 24 HAS and PWE buyer positions and 9 procurement positions in consolidated departments
- Bring together end users, DPUs, and legal early in purchasing process to reduce rework on contracts over \$50,000

2. Improve SPD services. SPD must increase their focus on departmental needs and improve levels of customer service

- Simplify the purchasing process for transactions less than \$50,000 by consolidating requirements and establishing citywide contracts
- Implement customer surveys and incorporating feedback into performance evaluations
- Fully implement 360° feedback assessments to ensure high service levels

3. Organize SPD to Deliver Savings. SPD must invest in new capabilities and focus on value-added service to capture savings opportunities

- Strengthen SPD skill sets and expertise for purchases over \$50,000 with new or restructured positions: spec writers, contract paralegal, analysts, and process & compliance auditors
 - Perform market and life-cycle cost analyses to identify and quantify savings opportunities across the City, such as the enforcement of purchasing through pre-existing contracts
 - Implement quarterly planning and forecasting audits to analyze future cost savings opportunities
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Estimated Impact

The opportunities discovered in the assessment phase represent \$40.3M with another \$3.1M through increased productivity. We arrived at this estimate through a detailed analysis of a subset of current contracts and spend data. In total, \$10.2 M in specific opportunities were found, such as enforcing purchases through pre-existing contracts (see Exhibit I - "Strategic Management – Verified"). Given time constraints, detailed analysis of all contracts and data wasn't feasible. For the remainder of the data, we extrapolated similar savings rates based on what was found in the deep dive, resulting in an additional \$29.6M in savings (see "Strategic Management – Estimated"). As a reality check, this represents a 5% savings rate adjusted to the municipal environment and is conservative when compared with average 15% savings rates typically seen in the corporate sourcing strategy efforts. Process streamlining to reduce duplication of efforts also allows for a reduction of resources, resulting in \$1.9M in annual savings. The anticipated costs are primarily found in new and upgraded positions totaling a relatively minimal \$1.4M per year. Implementing the recommendations will net a positive return this fiscal year and reach the full annual return by FY12. Booz & Company findings are supported by due diligence by the ARA team and detailed implementation plans are available in the attached binder. Upon receiving approval, the team is prepared to move directly into implementation.

Benefits Summary

Estimated Net Benefits (\$Millions)¹

	FY10	FY11	FY12
Benefits			
Strategic Management - Verified ²	3.0	10.2	10.2
Strategic Management - Estimated ³	3.7	14.8	29.6
Headcount Redeployment	-	1.0	1.9
Total benefits	6.7	26.0	41.7
Costs			
New positions	(1.0)	(1.3)	(1.3)
High grading of existing positions	(0.1)	(0.1)	(0.1)
Physical build-out and relocation	(0.1)	-	-
IT contractors	(0.1)	-	-
Total costs	(1.2)	(1.4)	(1.4)
Net Benefit	\$ 5.4	\$ 24.6	\$ 40.3
Increase in Productivity (Indirect Savings) ⁴	1.9	2.9	3.1
Total Net Benefit	\$ 7.3	\$ 27.5	\$ 43.4

¹ Not discounted over time

² Verified benefits from strategic management include estimates from the five specific listed opportunities; calculated from SAP spending data

³ Estimated benefits calculated for all spend except capital improvement, stock transfers, HAS, CEF by comparing % dept savings to SPD baseline - estimate increase to 5% average savings by department

⁴ Benefit of more efficient process is based on compensation and time saved from streamlining for DPU's, Directors, Dept Buyers, End Users, SPD, and Legal